



Issues Raised By the Empire Conversion

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Throughout the symposium, speakers and participants discussed and examined the conversion of Empire Blue Cross and Blue Shield from several perspectives. New Yorkers for Accessible Health Coverage (NYFAHC) was asked to give a sense of the desires of consumers. This paper reports consumers' concerns.

Consumers' View of Empire Blue Cross

It is fair to say that consumers are conflicted. A significant number of community groups feel strongly that the ethical position is to oppose Empire's conversion. New Yorkers have long looked to Empire as their insurer of last resort, a life raft of coverage if they could afford it, a last shelter in the storm. Consumers have repeatedly intervened with the legislature, petitioned governors, and prepared testimony considering Empire's special status. Some 4 million policy holders have preserved comprehensive coverage, in some cases at great economic hardship, in the face of years of annual rate increases, phase-outs of policies, and the recent move to convert the remaining TraditionPlus individual indemnity policies to BlueChoice managed care.

People with chronic illnesses and disabilities and the frail elderly have every reason to be concerned about being left at the mercies of the marketplace. They know that the marketplace does not readily take on certain burdens.

Now New Yorkers' life raft, their insurer of last resort, will become just another for-profit company. When we face the issue

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of conversion pragmatically, we understand that the marketplace has been transformed through the widespread use of managed care; that Empire has faced an increasing challenge from its for-profit competitors; that much of Empire's social mission has, by statute, been distributed across the commercial marketplace; and that, as a result, Empire has made real strides in replenishing its reserve level. It is also true that Empire is not alone in facing hard choices. We have heard about the conversions of nonprofit insurers, especially other Blue Cross plans, in state after state in recent years.

Seeing Empire's conversion and that of the other nonprofits as almost inevitable, our goals, simply stated, are to protect as much of the charitable assets as possible and to make sure that they are used to further the coverage and access to health care of the people of this state.

NYFAHC's Involvement with Empire Blue Cross and Blue Shield

New Yorkers for Accessible Health Coverage was formed in reaction to Empire Blue Cross's 1991 proposal to split their insured lives between the sick (who would get a 50% increase in premium) and the well (who would receive a 20% discount). Convening the groups serving New Yorkers with chronic illness and disabilities, seniors and working people, we advocated as a coalition for accessible, affordable, comprehensive, and appropriate coverage on the state level. We have been involved in a wide range of issues involving Empire Blue Cross. For the past 6 years, NYFHC has worked pragmatically to achieve protection and expansion of coverage. In 1992, in response to Empire's "pool splitting" proposal, we were a key part of the coalition that secured passage of the Community Rating Bill, landmark legislation that mandated open enrollment and community rating in the individual and small-group market. One of the provisions of this bill, portability of coverage, was expanded through our efforts to the entire marketplace the following year. In late 1994 Empire Blue Cross and Blue Shield stopped selling individual policies. None of

the HMOs then in the individual market offered prescription coverage and few offered individual point-of-service options. NYFAHC was instrumental in leading a state-wide call for reforms of HMO offerings, resulting in passage in 1995 of the Point-of-Service legislation. This mandated that all individual HMO policies must include prescription coverage, and that all HMOs marketing in the individual market must offer both basic and “point-of-service” plans. Point-of-service plans give insured people coverage for out-of-network physician visits. In 1996 NYFAHC supported legislation, which was enacted, preventing Empire from terminating coverage for its Medicare-eligible disabled enrollees who would have had no adequate replacements when Empire terminated its direct-pay policies. We also joined forces with Governor Pataki and Senate and Assembly leadership to pass the Consumers Managed Care Bill of Rights. This legislation provides vital protection for those covered by managed care, including, but not limited to, an expedited grievance review and appeal process, standards for utilization review, elimination of provider “gag clauses,” and enhanced access to specialists for the seriously ill.

Blue Cross Conversions

In the current market climate, Blue Cross licensees across the country are converting to for-profit status. NYFAHC works closely with Consumers Union, which has a nationwide project to track these conversions and help local advocates anticipate issues that may arise. Their knowledge of the diverse paths conversions in other states have taken has focused and informed our concerns regarding Empire’s conversion. Based on this rich experience, we have prepared our joint Statement of Principles to state clearly the protection we expect from regulators as we face the many transitions inherent in this conversion.

Continuation of Social Good

As described below, we have concluded that Empire’s conversion should result in funding a foundation with a health-related

mission under section 501(c)(3) of the Internal Revenue Code. The issue for us is not solely what the Foundation does after conversion, but also what Empire, the insurance company, does in the marketplace. The continued provision of certain social goods must be guaranteed even after the company is a for-profit entity. For example, it is vital that those policy holders who are currently Medicare-eligible disabled holders of Empire's TraditionPlus coverage be protected. Because of federal Medicare regulations, these consumers are prohibited from buying alternative coverage of comparable quality and comprehensiveness.

In 1996, the Legislature passed a bill making it possible for the remaining 850 policy holders to keep their coverage. Although Empire has stated its intention to retain these policies after the conversion, we believe that formal protection, whether through contract or legislation, is required as Empire loses its Article 43 status. Further, if the company is sold or merges with another insurer, these policy holders must retain their comprehensive policies.

A second social good that must be carried forth after the conversion is continuing provision of Medicare Supplemental indemnity coverage as an option for the elderly and disabled.

Open Process

It is crucial that the conversion process be open, with numerous opportunities for public hearings and disclosure. New York has an extremely sophisticated body of health-care consumer advocates with a long history of working closely with the legislature. When the community gains access to the transition documents and the regulatory agencies provide public hearings and opportunities for public comment, the public's interest can be protected and preserved. Indeed, providing opportunities for public scrutiny often aids regulators in crafting conversions that are more protective of charitable assets and result in capturing more of value of the assets. Conversely, those conversions in which public advocates were

excluded resulted in undervaluation of assets and significant public opposition to the conversion.

Value of the Corporation

A real danger in for-profit conversions is undervaluation of the new corporation's assets. This undervaluation can be reached by relying only on the value of "tangible assets," (often a statutory definition unrelated to the market value of the business), by using only one measure of valuation, rather than a variety of standard valuation techniques, or by ignoring the value the new corporation may have to a third party.

Abuses in valuing previous conversions, particularly the earliest ones, resulted in significant disparities between amounts given to charity at or near the time of conversion, and the valuation of those businesses when they subsequently went public or were sold to other insurers. The magnitude of these disparities has created such an outcry that management in more recent conversions have made more good-faith efforts in valuing their for-profit corporations to avoid regulatory delay and consumer backlash.

This is not to say the issue of undervaluation has gone away—rather, it has become more subtle and sophisticated. Pending conversions in Texas and Ohio are currently grappling with concerns about undervaluation of assets. Regulators and consumers now engage in dialogues regarding reserve levels, numbers of contracts, the sizes of provider networks, and the value of the Blue Cross trademark.

Further complexity is created by the foundation's need for liquidity, to raise cash to fulfill its mission. Does shareholder awareness of the "overhang" of unsold shares held by the foundation depress the share price the foundation can receive for its shares? What are the implications for valuation of any ownership restrictions the National Blue Cross/Blue Shield Association might impose on the conversion? What happens if the converted corporation is sold or merges with another company at a higher price shortly after the foundation has sold its shares?

We have urged the Attorney General to hire (at Empire's expense) investment bankers and other outside experts with expertise in this area to help answer these questions and structure the conversion to capture the fullest value of the charitable assets for the foundation. The process of retaining these experts should move as quickly as possible, as these are complex issues requiring significant analysis and review.

Importance of an Independent Board of Directors and Consumer Representation

The board of directors of the new foundation must be independent of Empire and must have an accountable, diverse, consumer membership reflecting the various communities served by Empire. Without board independence and accountability, emerging conflicts of interest cannot be avoided. It would be the board's job to formulate and to carry out the mission; if there are members who sit on the boards of both the insurance company and the foundation, the mission and activities of the foundation are likely to become enmeshed with the needs of the insurance company.

Members of Empire's board do not necessarily have the expertise needed to oversee a charitable foundation. Our chief objection to board overlap is not member expertise, however, but the conflict that will inevitably emerge between the goals of a foundation board directed to expand access to health care and a for-profit insurance company board to whom expanding access makes sense only if it means expansion of its own customer base. Therefore, we feel that the board must be accountable to the communities currently served by Empire, must be free of conflicts of interest, and must be independent of both the current Empire board and the board of the for-profit insurance company that will be created through the conversion.

501(c)(3) Status

The foundation should be created as a 501(c)(3) entity under the federal tax code. This would insure special reporting, grant-

making, and accountability requirements enforced by the Internal Revenue Service. The importance of this foundation's mission to consumers is too great to entrust it to 501(c)(4) status, which would involve much looser oversight, would relieve the foundation of requirements that it make charitable grants, and would allow its assets to be used for campaign contributions, lobbying activities, or in proposals that directly benefit the foundation's directors or managers.

Mission

In Dickinson, Tennessee, the new foundation endowed by the sale of the local hospital bought two planes and instituted flying lessons, financed a performance of Handel's *Messiah*, and installed video conferencing in the local college. In Lancaster, South Carolina, a similar foundation financed the construction of a new science wing at the University of South Carolina. The initial proposal for California's Blue Cross plan conversion included endowment of two university chairs in managed care. Although these are perhaps extreme examples, it is easy to see how conversion foundations in other states have spent their funds in ways that did not meet their former charitable intent.

We feel that the mission of the foundation should be shaped by the board of directors. However, under state law and the *cy pres* doctrine, the mission must hew closely to Empire's nonprofit mission: "meeting the unmet health care and health care coverage needs of New Yorkers." Currently there are 3 million New Yorkers without insurance coverage; estimates of the number of underinsured range as high as an additional 3 million. The mission of the foundation must be twofold: to expand the health insurance safety net to include those who cannot afford coverage or who have coverage that is inadequate to meet their needs; and to augment and create health programs that deliver health-care services to populations unable to access health care simply through insurance coverage. We recognize, sadly, that a foundation cannot substitute for a social insurance mechanism, but believe that something

critical will be lost if it does not at least promote and foster such a mechanism.

NYFAHC members know what it means to face chronic illness, disability, and loss of job-related coverage. We deal daily in the needs of concerned, confused families who lie awake at night uncertain if they will get or keep coverage. The new foundation could play a vital role in helping more New Yorkers get coverage or in providing the services that the disenfranchised need. Essential to Empire's conversion are open, public process, expert financial advice on the crafting of the conversion, careful choice of an independent, accountable, representative board with a large consumer representation, 501(c)(3) status, and a mission that protects the current Medicare-eligible TraditionPlus policy holders. We urge the Attorney General and the Insurance Department to remember all New Yorkers in the clash of special interests who will be competing for this money, and to look to them for leadership in guiding us through this difficult process.